BLANK PAGE

FILE COPY

Office Supreme Court, U. S.
FILED
JAN 26 1940
CHARLES ELMORE CROPLEY
CLERK

No. [redacted] 13

In the Supreme Court of the United States

OCTOBER TERM, 1939

UNITED STATES OF AMERICA, PETITIONER,

v.

ARTHUR OLIVER STEWART

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BLANK PAGE

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Specification of errors to be urged	3
Reasons for granting the writ	4
Conclusion	5
Appendix A	6
Appendix B	9

CITATIONS

Case:	
Stern Brothers & Co. v. *Commissioner*, decided January 5, 1940	4
Willcuts v. *Bunn*, 282 U. S. 216	3
Statutes:	
Act of March 8, 1938, c. 44, 52 Stat. 107	4
Federal Farm Loan Act of 1916, c. 245, 39 Stat. 360:	
Sec. 26 (U. S. C., Title 12, Sec. 931)	3, 6
Revenue Act of 1916, c. 463, 39 Stat. 756:	
Sec. 2	7
Sec. 4	7
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 22	6
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 817 (U. C. S., Supp. IV, Title 12, Sec. 931a)	8

204767—40

BLANK PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

ASHBY OLIVER STEWART

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered in the above cause on August 30, 1939.

OPINIONS BELOW

The opinion of the District Court (R. 36–43) is reported in 24 F. Supp. 145. The opinion of the Circuit Court of Appeals is reported in 106 F. (2d) 405.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 30, 1939. On November 24, 1939, Mr. Justice Reed entered an order

extending the time within which a petition might be filed for a period of sixty days from November 30, 1939. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether gain realized by a taxpayer upon his dealings in bonds issued by joint stock land banks under the Federal Farm Loan Act of 1916 is exempt from federal income taxation.

STATUTES INVOLVED

The statutes involved are set forth in Appendix A, *infra*, pp. 6–8.

STATEMENT

The taxpayer and his wife [1] during the year 1930 purchased farm loan bonds issued under the Federal Farm Loan Act of 1916 by two joint-stock land banks, some of which in the year 1931 they surrendered to the receivers of the issuing banks for liquidation for an amount in excess of what they had paid therefor and the remainder of which they sold for an amount in excess of the purchasing price (R. 36).

The purchases were made for the prospective increment to the bonds and not for the interest therefrom (R. 42).

---

[1] Appellant in No. 9101, below, which case was consolidated with this case, and will be controlled by the final decision herein.

The Commissioner of Internal Revenue ruled that the gain arising from such dealings in the bonds in question, over $84,000 (R. 36), was taxable income. The taxpayer included this income in his tax return for the year 1931, and paid the tax due because of such inclusion. He then filed due claim for refund on the ground that the gain upon disposition of the bonds was exempt from tax under Section 26 of the Federal Farm Loan Act, as amended, which provided that such bonds "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation" (R. 16–19). Upon rejection of the claim for refund (R. 23–25), this suit for refund was instituted.

The District Court determined that the gain so realized was income to the taxpayer and not within the exemption (R. 36–40). The Circuit Court reversed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the gains derived from the dealings in the bonds in question were exempt from federal income tax.

2. In unduly limiting the principles enunciated in *Willcutts* v. *Bunn,* 282 U. S. 216.

3. In reversing the judgment of the District Court and in remanding the case.

4. In failing to sustain the tax upon the gain so derived.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in direct conflict with that of the United States Circuit Court of Appeals for the Eighth Circuit in *Stern Brothers & Co.* v. *Commissioner,* decided January 5, 1940, the opinion in which is reprinted, *infra,* in Appendix B.

2. The Circuit Court has erroneously construed an important federal statute which has not been but should be construed by this Court. While in Section 26 of the Federal Farm Loan Act of 1916, *infra,* Congress used the relatively broader clause exempting the bonds "and the income derived therefrom" instead of the *interest* derived therefrom, it was never intended that gains derived from dealings in the bonds should be exempt. While this statute was prospectively amended in 1938 (Appendix A, *infra,* p. 8), so as to remove any doubt as to the existence of the exemption, the question here presented is nevertheless one of general importance. Not only will a final decision in this case control other pending claims, involving large amounts of money, but it will affect the construction of other recent statutes, such as Section 5 of the Act of March 8, 1938, c. 44, 52 Stat. 107, in which the same broad exemption clause is used, and pursuant to which large numbers of bonds are now being issued.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

JANUARY 1940.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(4) *Tax-free interest.* — Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. * * *

Federal Farm Loan Act of 1916, c. 245, 39 Stat. 360:

SEC. 26. That every Federal land bank and every national farm loan association, including the capital and reserve or surplus

therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation. * * * (U. S. C., Title 12, Sec. 931).

Revenue Act of 1916, c. 463, 39 Stat. 756:

INCOME DEFINED

SEC. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: * * *

SEC. 4. The following income shall be exempt from the provisions of this title:

* * * interest upon the obligations of a State or any political subdivision thereof

or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen; * * *.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 817. INCOME FROM OBLIGATIONS AND MORTGAGES ISSUED BY JOINT-STOCK LAND BANKS.

Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation (U. S. C., Supp. IV, Title 12, Sec. 931a).

APPENDIX B

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 11555—NOVEMBER TERM, A. D. 1939

On Petition to Review Decision of the United States Board of Tax Appeals

STERN BROTHERS & COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(January 5, 1940)

Before STONE, SANBORN, and THOMAS, Circuit Judges

SANBORN, *Circuit Judge,* delivered the opinion of the Court.

This is a petition to review a decision of the Board of Tax Appeals redetermining deficiencies in the income taxes of the petitioner for the years 1934 and 1935. The facts were stipulated. During the years in question the petitioner sold at a profit bonds of Joint Stock Land Banks issued under the Federal Farm Loan Act of July 17, 1916 (c. 245, 39 Stat. 360). Believing that the profits derived from the sale of these bonds were exempt, the petitioner did not include them in taxable income in making its returns. The Commissioner, being of the opinion that these profits were taxable, added

them to the income of the petitioner subject to tax, and proposed deficiencies accordingly. This led to the proceedings before the Board and the decision of which the petitioner now complains.

The sole question presented is whether the profits in suit were nontaxable because of Section 26 of the Farm Loan Act, which, so far as pertinent, provided that bonds issued under the Act "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation" (c. 245, 39 Stat. 380; Tit. 12, U. S. C., § 931). The Board in this case and in the case of *Stewart* v. *Commissioner*, 39 B. T. A. 1103, has ruled that Section 26 did not exempt profits derived from the sale of such bonds. *Stewart* v. *United States*, 24 F. Supp. 145, which was to the same effect, was reversed by the United States Circuit Court of Appeals of the Ninth Circuit in *Stewart* v. *United States*, 106 F. (2d) 405, that court being of the opinion that Section 26 exempted all income from such bonds, including gains derived from the sale thereof. This divergence of informed opinion as to the meaning and scope of Section 26 indicates that the question will not be put to rest until it has been decided by the Supreme Court of the United States.

It would serve no useful purpose to state the contentions of the parties, which are in substance the same as those considered by the Board and by the Circuit Court of Appeals of the Ninth Circuit in the cases referred to, or to express at length our views with respect to the proper construction of Section 26. We offer no criticism of the reasoning

with respect to the meaning of Section 26 upon which the conflicting opinions are based. The judges who decided *Stewart* v. *United States,* 106 F. (2d) 405, were convinced that the language of Section 26 was unambiguous and expressed the intent of Congress that profits derived from the sale of bonds issued under the Act should be nontaxable. Being of that view, they could have reached no other conclusion than that such profits were exempt. On the other hand, a majority of the members of the Board of Tax Appeals were of the opinion that a doubt existed as to the meaning and intent of Section 26, which doubt they were required to resolve in favor of the Government. See *Swan & Finch Co.* v. *United States,* 190 U. S. 143, 146; *Cornell* v. *Coyne,* 192 U. S. 418, 431; *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491.

We think there is a doubt as to whether Section 26 was ever intended to exempt profits derived from the purchase and sale of bonds issued under the Farm Loan Act. We agree that the language of Section 26 is susceptible of a construction which would make such gains nontaxable, but we do not agree that that is the only meaning which may be accorded to the language used. There are several considerations which have influenced us in reaching this conclusion. One is that shortly after having passed the Farm Loan Act, Congress, in enacting the Revenue Act of 1916, provided in Section 4, c. 463, 39 Stat. 756, 758, as follows:

> SEC. 4. The following income shall be exempt from the provisions of this title:
>
> * * * interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under

> the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen; * * *.

This language, was, we think, inserted in the Revenue Act in an attempt to make the exemption therein provided for with respect to the income derived from bonds issued under the Farm Loan Act correspond with the exemption which had already been granted by the terms of Section 26 of that Act, and indicated that Congress did not then regard income derived from the sale of such bonds as having been exempted from taxation. Another consideration is that we can see no practical justification for the granting of such an exemption. The bonds to be issued under the Act were of a character which would normally be attractive to investors, and not to speculators or those who buy securities for the purpose of deriving a profit from their sale. It seems to us that it was the exemption of the income to be derived from investing in and holding such bonds, rather than the exemption of the profits to be derived from buying and selling them, which would make the bonds marketable, and thus be of advantage to those for whose benefit the Farm Loan Act was passed.

The case of *Willcuts* v. *Bunn*, 282 U. S. 216, which is relied upon by the respondent, but which dealt with an implied constitutional immunity from taxation and not with a specific statutory exemption, demonstrates that a gain derived from the sale of a bond which is an instrumentality of government stands in a different situation than the income derived from having and holding such a bond, and is persuasive that Congress might well have intended that the words "income derived therefrom," as

used in Section 26, should be read as covering only such returns as result from the owning and holding of such a bond, and not covering gains derived from its sale. It sometimes happens that a well-founded belief in the existence of an express immunity from taxation proves to be an illusion. *O'Malley* v. *Woodrough*, 307 U. S. 277.

It is our conclusion that there is nothing in the language of Section 26, or in its legislative history, or in the administrative rulings made with regard to it, or in subsequent legislation dealing with the same subject matter, which conclusively establishes that the profits derived by the petitioner from the sale of the bonds in question were nontaxable. We are not convinced that the Board's decision was erroneous.

The order of the Board is

Affirmed.

U. S. GOVERNMENT PRINTING OFFICE: 1940